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Sessional Committee

DRAFT REPORT OF THE SESSIONAL COMMITTEE OF THE SPECIAL COMMITTEE ON PREFERENCES

Chairman: Mr. Abdeljebbar Brahime (Morocco)

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INTRODUCTION

1. The Sessional Committee to deal with questions of the "Rules of Origin" was formerly set up by the Special Committee on Preferences at its 174th plenary meeting on 19 May 1992. This action was taken in accordance with the recommendation of the Ad hoc Intergovernmental Working Group on the In-depth Study of the United Nations Intergovernmental Structure and Functions in the Economic and Social Fields.

2. At the Sessional Committee's 1st meeting on Tuesday, 19 May 1992, Mr. Abdeljebbar Brahime (Morocco) was elected Chairman.

3. The Sessional Committee held two meetings from 19 to 20 May 1992.

Chapter II

HARMONIZATION AND IMPROVEMENT OF THE RULES OF ORIGIN

(Agenda item 4)

4. For its consideration of this item the Special Committee on Preferences had before it the following documentation:

"Examination of definitions of 'substantial transformation' and implications of harmonization: possible initiatives in regard to simplification and liberalization" (TD/B/C.5/141);

"Improvements in the rules of origin, including harmonization: identification and promotion of possible initiatives" (TD/B/C.5/120).

5. At its 174th plenary meeting, the Special Committee established a sessional committee of the whole to consider and report on agenda item 4.

6. The Director and Coordinator of the International Trade Programme, in introducing document TD/B/C.5/141 and Corr.1, said that as a follow-up to agreed conclusion 12 (XVII) and resolution 13 (XVIII) of the Special Committee on Preferences, provision had been made for a sessional committee on the rules of origin to be convened at the present session.

Consideration of the Sessional Committee

7. The spokesman for the Group of the Asian countries (Malaysia) said that harmonization, simplification and liberalization of the rules of origin had now been discussed in committees and working groups for almost 20 years. Developed countries had accepted, in principle, the need for harmonization and simplification and would consider concrete cases of liberalization. The only practical outcome so far had been extensive harmonization of the process criterion. The percentage criterion remained as diverse as ever. It was imperative, in view of the complexity and stringency of the rules of origin and their restrictive effects on GSP utilization, to resolve the present stalemate.

8. So far as concerned the long-established proposals contained in document TD/B/C.5/120, the preference-giving countries should now be able to respond. On the recent proposal to introduce full harmonization, as discussed in document TD/B/C.5/141, most countries would wish to give further consideration to the matter although preliminary views might be heard at the present

session. The opportunity should be taken to explore ways and means to carry the work of the sessional committee forward. To this end, an item-by-item discussion on an informal basis might prove useful.

9. The representative of Sri Lanka said that the rules of origin continued to present a major obstacle to the achievement of GSP objectives; hence it was imperative that they be reformed. Evidence of difficulties encountered by preference-receiving countries persisted. The diversity and the over-restrictiveness of the existing rules operated to the detriment of Sri Lankan industry. For example, in the case of many textile products, e.g. cotton under HS heading 61.01, the process criterion demanded manufacture from yarn. Thus, fabric not available from domestic sources could not be used even if its value amounted to less than 50 per cent of the value of the exported products. GSP coverage of exports to the EEC were thus not possible. Another example was toys (HS heading 95.43) for which it was necessary to import some parts (also under heading 95.43) from Germany. The finished toys were exported to Belgium but did not obtain GSP. Such restrictions were a particularly serious matter for small economies.

10. As regards "preference-giving country content" and full global cumulation, application of these concepts by all preference-giving countries would be beneficial not only in terms of liberalizing the restrictiveness of the origin rules but would promote international trade between both preference-giving and preference-receiving countries. Foreign investment would be encouraged. Examples of beneficial effects were consistent with modern economic thinking which favoured the liberalization of trade regimes and the play of market forces. Where current cumulation provisions applied only to regional groupings, preference-receiving countries not members of such groupings were discriminated against. For example, the mixing and blending of imported tea with Sri Lankan tea would disqualify it for GSP whereas such production within a regional grouping would so qualify. As concerned harmonization, while the percentage criterion was originally favoured as the preferable unified rule, in view of the now widespread adoption of the HS system, Sri Lanka would be prepared to accept the process criterion as the basis for harmonization. Some improvements were still necessary, however, especially simplification.

11. The representative of China said that it was undeniable that implementation of GSP had fallen short of reaching all the goals envisaged in Resolution 21 (II), adopted by the UNCTAD Conference in 1968. The root cause of this was the overly stringent rules of origin promulgated by preference-giving countries because they posed obstacles to exporters from developing countries. He commended the Governments of Australia, Canada and New Zealand for adopting the principles of "preference-giving country content" and "global cumulation" in their respective country of origin rules. Regrettably, most preference-giving countries had not yet applied these principles to their schemes. Some countries, while adhering to the principle of preference-giving country content, had nevertheless excluded many products, thus curtailing the effectiveness of the principle. He appealed to all countries to adopt these two principles as this would allow the GSP to play a more effective role in world trade. One effective means to realize the objectives of GSP would be to harmonize, improve, and simplify rules of origin criteria. Lack of harmony had created technical obstacles for both certifying authorities and exporters in preference-receiving countries. For example, a tape recorder under HS 8520 under EEC, Japan and EFTA rules of origin had different stipulated requirements. In order to export the same products to these three markets, different criteria of rules of origin had to be met. To do so, producers were forced constantly to modify in their production processes the composition of new raw material and parts. Since most preference-giving countries had adopted the HS nomenclature, he proposed using tariff heading criteria to determine the origin of the goods. Finally, China wished to express agreement with the statement in chapter I of TD/B/C.5/141, which emphasized resolution 13 (XVIII) adopted by the Special Committee at its eighteenth session.

12. The representative of the United States of America said that rules of origin had been included in his country's review of its GSP scheme. An open view existed as to the nature of any revision. He expressed two concerns about harmonization. First, as indicated in document TD/B/C.5/141, there appeared to be no firm basis for identification of the better of the two criteria; there were disadvantages and advantages to both. Secondly, if the purpose of harmonization was to liberalize GSP trade, other and more suitable methods might be employed.

13. The representative of Malta fully agreed that the diversity of rules of origin acted as an obstacle to exporters. Harmonization of the origin criteria would increase their opportunities. She cited examples where specific products under specific schemes had encountered problems. In the case of Canada, imported gold bullion manufactured into high-quality gold chains in Malta did not qualify under the origin rules. Despite the fact that a significant amount of value was added locally by the manufacturing process, the imported gold bullion exceeded by its very nature 40 per cent of the ex-factory price. Neither a donor-country content provision nor full and global cumulation would help in such a case as the gold bullion was sourced elsewhere. Under the United States rules of origin, the same product would have qualified as the imported bullion was substantially transformed and would have counted towards local content. Similarly, under the GSP schemes of Japan, EFTA preference-giving countries and the EEC, the product would qualify since the "change of tariff heading" requirements would have been met. Under chapters 84 and 85 for the schemes of EFTA preference-giving countries and Japan, compliance with the origin criteria was difficult. Moreover, under certain HS headings, four rules of origin were stipulated. The GSP schemes of EFTA preference-giving countries did not make provision for donor-country content or global cumulation. Finally, the 5 per cent requirement on specific parts posed a problem as it generally concerned a significant component of the final product.

14. There were various advantages and disadvantages to both the process and percentage criterion methods. The percentage criterion was the easiest to understand and meet. In fact the criterion applied to all GSP eligible products included in a particular scheme and most manufacturers were familiar with the concept of value added. However, there were still some discrepancies between schemes. There was confusion, for instance when two countries (Australia and New Zealand) indicated a minimum local value added requirement (50 per cent in both cases), while the others indicated a maximum foreign input allowance. Another inconsistency had arisen from the use of the f.o.b. price as the basis for calculation by three countries that applied the percentage criterion (Bulgaria, Hungary and Poland), while other countries applied the ex-factory price or ex-factory cost. The United States scheme also applied a percentage rule, but it was distinct from the method used by all the other countries. In fact it was not particularly advantageous because

only the costs of direct processing and of local materials could be counted towards this minimum percentage requirement. Other countries that applied the percentage method of calculation had specified a higher minimum amount of local value-added, but had allowed profit, overheads, etc., to be included in the calculation.

15. On the other hand, the process criterion method was less preferable. While not difficult to understand in itself, it was less "user-friendly" because a single rule or criterion could not be uniformly applied to all GSP-eligible products, even under a single scheme. Furthermore, additional rules were often quite difficult to comply with as it frequently happened that two, three or even four rules had to be satisfied in order to guarantee originating status for the product. Finally, the "change in tariff heading" rule required that, minimally, details of the HS category of the product had to be known, or alternatively the HS number of each imported input before confirming the originating status of the finished product. This could prove tedious and inconvenient, and in either case, the exporter required outside assistance.

16. Commending the donor country content and global cumulation rules, she said that there was no doubt that the schemes of Canada, Australia, New Zealand, Poland, Czechoslovakia, Hungary, Bulgaria and the former USSR were the most favourable since both concessions were allowed. Japan did apply the donor country content rule, but with some restrictions which detracted from its initial appeal: first a number of products could not benefit from this concession, and secondly, particular documentary evidence was required for this concession. If harmonization with the other preference-giving countries were to take place, this would certainly make the Japanese scheme more practical. The schemes of the EFTA preference-giving countries, the EEC, the United States and Japan allowed only limited cumulation, i.e. only among selected regional groupings, while only Japan allowed the donor-country content rule. This discriminated against countries like Malta which were not associated regionally or economically with other developing countries. There was some inconvenience as the manufacturer, in calculating the non-originating content of his production in order to qualify under the percentage criterion, had to segregate the local donor country and other GSP beneficiary originating materials from the rest. However, the advantage of increasing the chances of qualifying for GSP preferences

outweighed this disadvantage. Both the donor-country content and cumulation allowances were important for countries such as Malta, in view of foreign investment and joint venture arrangements.

17. With regard to "substantial transformation" under the United States GSP scheme, while it offered significant benefits by allowing "substantially transformed" imported inputs to be counted towards the local value-added, its subjectivity was a source of uncertainty. A hard and fast definition such as "a change in tariff heading" would help to make the system easier to use.

18. In considering harmonization of the schemes, Malta believed that the ideal situation would be a blend of the United States and Canadian schemes however difficult it would be to choose between them as both had their advantages and disadvantages. The positive aspects of the United States GSP scheme were duty-free treatment granted to all GSP-eligible products, broad product coverage and the "substantial transformation" allowance. The scheme of Canada's main advantages were full and global cumulation allowance, the donor-country content rule and broad product coverage. The drawback to the Canadian scheme was a consequence of the fact that no allowance was made for the "substantial transformation" or "change in tariff heading". Furthermore, the fact that the duty reduction under the GSP varied by product made it less straightforward in its application.

19. The representative of Thailand said that the failure of exports to obtain GSP preference was due to the application of restrictions by some major preference-giving countries on the use of imported materials. Some exports had to be made from materials not available or rarely found in Thailand. Preference-giving countries should not only harmonize their rules but also increase the percentage of non-originating materials which could be used. The list of products subject to special rules should be reduced. The percentage of non-originating materials (under the same HS heading as the finished product) allowed to be used in manufacture should also be increased.

20. The existence of variations in the rules of origin employed by preference-giving countries caused difficulties as often a particular process which qualified for preferential treatment under one scheme might not qualify under another GSP scheme. The rules of origin of the United States caused difficulty in terms of calculation of the percentage of domestic material plus direct processing costs, for example. Completion of Box 8 in Form A also posed problems but difficulties could be solved by harmonization and

simplification. Application of donor-country content rules would likewise lessen the restrictiveness of the origin rules. This concept could be introduced by all preference-giving countries. The use of "ex-factory" price as a denominator to calculate the percentage of materials used in processing has caused difficulties when exporters were not manufacturers. "F.O.B. price" should be used by all preference-giving countries since it was shown on the export invoice. When Thailand's certificates of origin Form A were rejected by the preference-giving countries, the Thai authorities had not always been informed of the reasons hence it was not always possible to avoid recurrence. Preference-giving countries, when rejecting a certificate of origin, should return a copy of the certificate, indicating the reasons for rejection. Differences in HS classification among the authorities concerned in the exporting and importing countries were also an obstacle to obtaining GSP preference.

21. The representative of Mexico said that both the percentage modality and the process modality offered advantages, but that it would be much easier for preference-giving countries to take advantage of the GSP schemes if the rules of origin were uniform under all the schemes. It was the view of his delegation that uniform criteria under both modalities would constitute an important and decisive step towards the establishment of a complete harmonization of the rules of origin. He also stressed the importance of full and global cumulation: its application to all the schemes would simplify the task of preference-receiving countries in complying with origin requirements.

22. The representative of the European Community said that the harmonization of the rules of origin on the basis of the process criterion had become possible following the widespread adoption by all preference-giving countries of the Harmonized Commodity and Coding System (HS). Preference-giving countries were gradually becoming familiar with the System and might thereby soon be able to apply the process criterion. The EC might consider relaxation of the process criterion on a case-by-case basis. As far as the adoption of the preference-giving country content rules was concerned, the EC was open to discussion. In order to alleviate the difficulties encountered by the least developed countries, tolerances in some percentages contained in rules might also be considered case-by-case.

23. The representative of Austria noted that in relation to the point raised by Sri Lanka, when it had agreed to establish a GSP system more than 20 years ago, prospective preference-receiving countries as a whole were against the concept of donor-country content rule because it might create vertical lines of trade. It might be appropriate to analyse any possible negative effects arising from application of this concept. Referring to paragraph 76 of the document TD/B/C.5/141, he pointed out that the EFTA preference-giving countries also applied "partial and regional" cumulation which was currently used by one regional grouping. Although there was a request from member States of SADDC, the response required from SADDC had not yet been received. Whether or not the preference-giving countries could agree on common action, the secretariat was still to be commended for the quality of report TD/B/C.5/144 which had been prepared to give guidance on the discussions. Austria, like other preference-giving countries of EFTA had decided to harmonize its rules of origin as closely as possible to those of the EEC scheme, in order to simplify matters for the preference-receiving countries and this limited its manoeuvrability.

24. The representative of Colombia observed that the lack of harmonization of the rules of origin represented an obstacle to the full utilization of the GSP schemes. In this regard, he said that harmonization and simplification of the rules of origin were of the highest importance - if the collective desire was to improve the preference schemes as instruments of economic development. In particular, either the implementation of the concept of limited harmonization, namely the simplification of the criteria used by donor countries, and of full harmonization, that is the replacement of one criterion by another, would have a positive impact on administrative costs and on the steps required to qualify for the schemes. As a direct consequence of the harmonization, the utilization rate would show that beneficiary countries were making more efficient use of the GSP schemes.

25. The representative of Finland said that Finland favoured simplifying the rules of origin and having harmonized rules of origin covering all the various GSP schemes of different countries.

26. The representative of Peru expressed the desire to see complete harmonization of the rules of origin.

27. The representative of Malta took the floor again to voice appreciation for the serious thought and expression of ideas that had taken place during the Sessional Committee in the area of harmonization and liberalization of the rules of origin. The various constructive comments made by a number of delegates had indicated that there was general agreement on both sides that simplification was necessary at this stage if the original aims of the GSP were to be achieved and the full benefits captured by the preference-receiving countries. She felt that the outcome of the session would carry the work forward in the right direction.